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Virginia Energy Corporation

1999
ANNUAL REPORT

CORPORATE PROFILE

Virginia Energy Corporation ("Virginia") is a publicly traded junior oil and gas company based in Calgary, Alberta. The Company's principal properties are located in Alberta.

Since its inception in 1996, the Directors and Management have focused on the identification, acquisition and farmout of working interests in oil and gas producing properties in Western Canada.

During 1999, the Company's philosophy has been to create cash flow through the development of the Sturgeon Lake property that had been acquired in 1996, while minimizing risk and capital exposure in doing so. As a result, the Sturgeon Lake property is being developed via a farmout agreement. Since October 1999, subsequent to the farmout agreement, Virginia participated in the drilling of three \$900,000 wells with financial exposure of only \$60,000. Additional farmout wells are planned for Sturgeon Lake.

Virginia will also use this same approach to bring into production the Company's gas property at Rainbow Lake.

Virginia has 16,116,499 common shares outstanding and trades on the Canadian Venture Exchange under the symbol VRG.

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ANNUAL AND SPECIAL MEETING

The Annual and Special Meeting of Shareholders will be held at 11:00 a.m. on May 25, 2000, in the Corral Room, at the Palliser Hotel, at 113 - 9th Avenue S.W., Calgary, Alberta.

REPORT TO SHAREHOLDERS

Virginia's net production averaged 31 boepd during 1999, resulting in net cash flow of \$38,322, or 0.2¢ per share.

During the year Virginia sold a 10% working interest and farmed out a 20% working interest in 6,500 acres at Sturgeon Lake. The sale and farmout agreement reduced the Company's share of gas conservation costs from \$167,000 to \$43,000 and reduced the cost of drilling to \$30,000 from \$300,000 for wells in which the Company will participate.

Gas conservation was necessary to comply with regulatory requirements to eliminate gas flaring and to conserve solution gas produced with the oil. Conservation also results in additional revenues from the sale of natural gas and associated natural gas liquids.

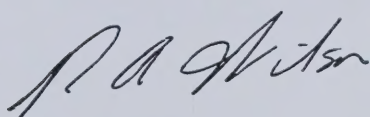
The first farmout well was successfully completed as a Leduc oil well in the fourth quarter of 1999, at no cost to the Company. Virginia holds a Gross Overriding Royalty (GOR) until payout of the well at which time the Company can convert the GOR to an 11% working interest. This well went on production in January 2000 at an initial rate of 350 boepd, which netted Virginia approximately 18 boepd from its GOR. Production problems have subsequently been encountered and the well has been suspended, pending a workover to restore production.

Two additional wells in which Virginia retained a 3.3334% working interest participation plus its GOR were drilled subsequent to year-end. One well was cased to the Leduc and will be completed after spring break-up, and the other was a dry hole.

More seismic is planned at Sturgeon Lake during 2000 to better define additional drilling targets for later in the year.

Also subsequent to year-end, the Company entered into an agreement whereby Virginia will be carried for all costs to tie-in and equip the company's 100% owned shut-in gas well in the Rainbow Lake area of Alberta. It is expected, the well will commence production soon after freeze-up in the fall of 2000 at approximately 2 mmcf/d, yielding Virginia 900 mcf/d, or 90 boepd from its 45% share of production.

On behalf of the Board of Directors,



Robert A. Wilson
President and CEO
April 10, 2000

REVIEW OF OPERATIONS

MAJOR PROJECTS

Sturgeon Lake

During the year Virginia sold a 10% working interest and farmed out a 20% working interest in 6,500 acres at Sturgeon Lake. The sale and farmout agreement reduced the Company's share of gas conservation costs from \$167,000 to \$43,000 and reduced the cost of drilling from \$300,000 to \$30,000 for wells in which the Company will participate.

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Two additional wells in which Virginia retained a 3.3334% working interest participation plus its GOR were drilled subsequent to year-end. One well was cased to the Leduc and will be completed after spring break-up, and the other was a dry hole.

More seismic is planned at Sturgeon Lake during 2000 to better define additional drilling targets for later in the year.

Rainbow South

Several operating companies have shown considerable interest in this area during the last two drilling seasons. It is likely that the Virginia Rains 6-2 shut-in gas well will be placed on production during the 2000/2001 drilling season. In March 2000 a farmout agreement was executed whereby after fall freeze-up the farmee will install gas production facilities at the Company's Rainbow 6-2 shut-in gas well and construct a 6 km pipeline to transport the gas to market. Virginia will pay no costs and retain a 45% working interest which, based on an anticipated production rate of 2 mmcf/d, will net the Company 900 mcf/d (90 boepd).

Zama Lake

Subsequent to year-end, the Company completed the abandonment of two well bores at Zama. No further activity is planned for this area.

Virginia Hills

No activity took place in the Virginia Hills area during 1999. Subsequent to year-end the Company disposed of its interests in this area.

PRODUCTION

The Company had three producing oil wells at the end of 1999 from which the Company's working interest averaged 31 bopd during the year.

LAND

At December 31, 1999, the Company had interests in 9,260 gross acres (3,830 net acres) of mineral leases all of which were in Northern and West Central Alberta. Subsequent to year end 960 gross acres (960 net acres) were disposed of in the Virginia Hills area.

THE YEAR IN REVIEW

During 1999, Virginia recorded a positive cash flow of \$38,332 on gross revenues of \$278,417 before royalties. Operating expenses of \$120,347, General & Administrative costs of \$48,868, interest charges of \$6,909 and depletion expense of \$296,316 resulted in a net loss of \$257,984.

CAPITAL SPENDING

Capital spending was made up of the following:

• land acquisition	\$10,000
• drilling and completion	46,934
• lease, well and battery	<u>85,137</u>
Total	<u>\$142,072</u>

INCOME TAX HORIZON

The Company has \$370,944 non-capital losses carry forward plus income tax pools of \$865,354, which can be used to reduce future taxable income.

BANK DEBT

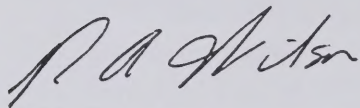
The Company has a bank debt at December 31, 1999 in the amount of \$35,000.

YEAR 2000 ISSUE

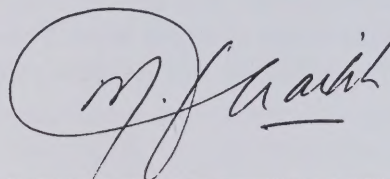
As of the date of this report, there have been no system related problems encountered that have had any impact on the operations or financial affairs of the Company.

MANAGEMENT'S REPORT

The annual report and financial statements have been prepared by management and approved by the Board of Directors. The financial statements have been prepared in accordance with generally accepted accounting principles. Management acknowledges responsibility for the fairness, integrity and objectivity of all financial information contained in the annual report, including the financial statements.



Robert A. Wilson
President & Chief Executive Officer



M. H. (Mike) Shaikh
Secretary & Chief Financial Officer

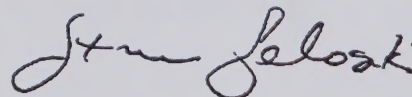
AUDITOR'S REPORT

To the Shareholders of Virginia Energy Corporation

I have audited the balance sheets of Virginia Energy Corporation as at December 31, 1999 and 1998 and the statements of operations and deficit and changes in cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1999 and 1998 and the results of its operations and changes in its cash flows for the years then ended in accordance with generally accepted accounting principles.



STAN PELOSKI
Chartered Accountant

Calgary, Alberta
March 25, 2000

VIRGINIA ENERGY CORPORATION

Balance Sheets As at December 31

ASSETS

	<u>1999</u>	<u>1998</u>
Current		
Cash	\$ 6,966	\$ 18,586
Accounts receivable	24,967	9,695
Prepaid expenses	<u>74,612</u>	<u>69,757</u>
	106,545	98,038
 Petroleum and natural gas properties, net (Note 3)	 <u>1,683,050</u>	 <u>2,052,358</u>
	 <u>\$ 1,789,595</u>	 <u>\$ 2,150,396</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	\$ 218,918	\$ 201,671
Bank debt (Note 4)	<u>35,000</u>	<u>60,000</u>
	253,918	261,671
 Long-term debt	 -	 100,000
 Provision for site restoration	 <u>10,656</u>	 <u>5,720</u>
	264,574	367,391
 Shareholders' equity		
Share capital (Note 5)	1,908,851	1,908,851
Deficit	<u>(383,830)</u>	<u>(125,846)</u>
	1,525,021	1,783,005
	 <u>\$ 1,789,595</u>	 <u>\$ 2,150,396</u>

VIRGINIA ENERGY CORPORATION

Statements of Operations and Deficit For the Years Ended December 31

	<u>1999</u>	<u>1998</u>
Revenue		
Petroleum and natural gas sales, net of royalties	\$ 213,537	\$ 259,897
Alberta royalty tax credit	673	-
Interest	<u>246</u>	<u>9,607</u>
	<u>214,456</u>	<u>269,504</u>
Expenses		
Operating	120,347	155,703
General and administrative	48,868	99,263
Interest	6,909	-
Depletion	<u>296,316</u>	<u>54,626</u>
	<u>472,440</u>	<u>309,592</u>
Net loss	(257,984)	(40,088)
Deficit, beginning of year	(125,846)	(85,758)
Deficit, end of year	\$ <u>(383,830)</u>	\$ <u>(125,846)</u>
Net loss per share	\$ <u>(0.016)</u>	\$ <u>(0.003)</u>

VIRGINIA ENERGY CORPORATION

Statements of Changes in Cash Flows For the Years Ended December 31

	<u>1999</u>	<u>1998</u>
Operating activities		
Net loss	\$ (257,984)	\$ (40,088)
Add non-cash item		
Depletion	<u>296,316</u>	<u>54,626</u>
Cash flow from operations	38,332	14,538
Net change in non-cash working capital	<u>(27,880)</u>	<u>2,686</u>
	<u>10,452</u>	<u>17,224</u>
Financing activities		
Increase (decrease) in long-term debt	(100,000)	100,000
Issuance of common shares	<u>-</u>	<u>100,000</u>
	<u>(65,000)</u>	<u>200,000</u>
Investing activities		
Disposition of petroleum and natural gas properties	220,000	257,000
Purchase of petroleum and natural gas properties	<u>(142,072)</u>	<u>(693,439)</u>
	<u>77,928</u>	<u>(436,439)</u>
Decrease in cash	(11,620)	(219,215)
Cash, beginning of year	<u>18,586</u>	<u>237,801</u>
Cash, end of year	\$ <u>6,966</u>	\$ <u>18,586</u>
Cash flow from operations per share	\$ <u>0.002</u>	\$ <u>0.001</u>
Interest paid	\$ <u>6,909</u>	\$ <u>-</u>

VIRGINIA ENERGY CORPORATION

Notes to the Financial Statements For the Years Ended December 31, 1999 and 1998

1. Incorporation

The Corporation was incorporated as 679601 Alberta Inc. under the laws of the Province of Alberta on January 2, 1996. On February 15, 1996 the Corporation filed Articles of Amendment and changed its name to Virginia Energy Corporation. The Corporation is engaged in the exploration and development of petroleum and natural gas properties.

2. Summary of significant accounting policies

The financial statements of the Corporation have been prepared in accordance with accounting principles generally accepted in Canada. The more significant accounting policies are the following:

a) Going concern

An assumption underlying the preparation of financial statements in accordance with generally accepted accounting principles is that the Corporation will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations.

The Corporation has incurred significant operating losses and has a substantial working capital deficiency.

These financial statements do not reflect adjustments which would be necessary if the going concern assumption were not appropriate. Management has taken action, including the sale of certain petroleum and natural gas properties and the negotiation of a farmout and option agreement with respect to its major property. As well, as described in Note 9, management has arranged a loan of up to \$500,000, which has enabled the Corporation to repay a significant portion of its accounts payable and will enable further development of its major property. Management believes that these actions mitigate the adverse conditions which raise doubts about the validity of the going concern assumption used in the preparation of these financial statements.

If the going concern assumption were not appropriate for these financial statements, adjustments would be necessary to the carrying values of assets and liabilities, net income and balance sheet classifications used.

b) Petroleum and natural gas properties

The Corporation follows the full cost method of accounting whereby all costs associated with the exploration for and development of petroleum and natural gas reserves are capitalized into a single Canadian cost centre and charged against earnings as set out below. Such costs include lease acquisition, geological and geophysical, carrying charges of non-producing properties and costs of drilling both productive and non-productive wells and related overhead charges.

Gains or losses are not recognized upon disposition of petroleum and natural gas properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of 20% or more.

Depletion is provided on costs accumulated in a producing cost centre using the unit of production method. For purposes of the depletion calculation, gross proved petroleum and natural gas reserves, as determined by outside consultants, are converted to a common unit of measure on the basis of their approximate energy content.

The Corporation periodically reviews the costs associated with unproved properties and preproduction stage cost centres to determine whether they are likely to be recovered. When costs are not likely to be recovered, an impairment allowance is made.

The net carrying costs of the Corporation's petroleum and natural gas properties in producing the cost centre is limited to an estimated recoverable amount. This amount is the aggregate of future net revenues from proved reserves and the costs of undeveloped properties, net of impairment allowances, less future general and administrative costs, financing costs, future site restoration costs and income taxes. Future net revenues have been calculated using prices in effect at the Corporation's year end without escalation or discounting.

c) Joint venture accounting

Substantially all of the Corporation's petroleum and natural gas exploration and production activities are conducted jointly with others and, accordingly, the accounts reflect only the Corporation's proportionate interest in such activities.

d) Future removal and site restoration costs

Estimated future removal and site restoration costs are provided for over the life of the proved reserves on a unit-of-production basis. Costs are estimated by management in consultation with engineers based on current regulations, costs, technology and industry standards. The annual charge is included in depletion expense and actual future removal and site restoration expenditures are charged to the accumulated provision account as incurred.

e) Flow-through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Petroleum and natural gas properties and equipment and share capital are reduced by the estimated income taxes related to the renounced income tax deductions when the expenditures are incurred.

f) Income taxes

The Corporation follows the tax allocation method of accounting for corporate income taxes. Deferred taxes are provided to the extent that current taxes have been reduced by claiming amounts, primarily exploration and development costs and capital cost allowance, in excess of the related depletion and amortization recorded in the financial statements.

g) Per share data

Net loss per share is calculated based on the weighted average number of common shares outstanding during the year. The weighted average number of common shares outstanding during the year is 16,116,499 (1998 - 15,081,939). Fully diluted net loss per share is not disclosed as the effects of the assumed share purchase options and warrants as disclosed in Note 5 would be anti-dilutive.

3. Petroleum and natural gas properties

	<u>1999</u>			<u>1998</u>
	<u>Cost</u>	<u>Accumulated Depletion</u>	<u>Net Book Value</u>	<u>Net Book Value</u>
Leases and rights	\$ 1,733,730	\$ 357,033	\$ 1,376,697	\$ 1,708,658
Lease and well equipment	<u>341,145</u>	<u>34,792</u>	<u>306,353</u>	<u>346,203</u>
	<u>\$ 2,074,875</u>	<u>\$ 391,825</u>	<u>\$ 1,683,050</u>	<u>\$ 2,052,358</u>

Costs associated with unproven properties excluded from costs subject to depletion for 1999 totalled \$210,177 (1998 - \$420,353). A charge for impairment of \$210,176, with respect to these properties, has been included in depletion expense for 1999.

Net book value of properties not subject to deduction for income tax purposes at December 31, 1999 was \$977,714 (1998 - \$1,018,900). These amounts reflect costs renounced by the Corporation pursuant to the issuance of flow-through shares (less the tax effect thereon) and the cost of properties acquired on a tax deferred basis, net of accumulated depletion.

4. Long-term debt

	<u>1999</u>	<u>1998</u>
Revolving reducing demand loan	\$ 35,000	\$ 160,000
Less, current portion	<u>35,000</u>	<u>60,000</u>
	<u>\$ -</u>	<u>\$ 100,000</u>

The National Bank of Canada, bearing interest at the bank's prime rate plus 1 ½% per annum (8% at December 31, 1999). The loan is secured by a general assignment of book debts and a general security agreement over all assets.

5. Share Capital

Authorized

Unlimited number of voting common shares
 Unlimited number of first preferred shares
 Unlimited number of second preferred shares

The first and second preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.

Issued and outstanding common shares

	<u>Number of Shares</u>	<u>Amount</u>
Balance as at December 31, 1997	15,116,499	1,808,851
Issued for cash pursuant to a private placement	<u>1,000,000</u>	<u>100,000</u>
Balance as at December 31, 1998 and 1999	<u>16,116,499</u>	\$ <u>1,908,851</u>

Pursuant to Escrow Agreements, 2,000,000 common shares issued to the founders of the Corporation and 2,118,750 common shares issued in consideration of the purchase of petroleum and natural gas properties are held in escrow by Montreal Trust. By July 31, 1999, all of the escrowed shares had been released from escrow in accordance with the escrow agreement.

Stock Options

The Corporation established a Stock Option Plan and granted options to directors as follows:

<u>Number of stock options</u>	<u>Exercise price per share</u>	<u>Expiry date</u>
200,000	\$0.10	April 22, 2001
900,000	\$0.20	June 27, 2002
375,000	\$0.10	June 30, 2004

Warrants

Pursuant to a Private Placement completed October 16, 1998, the Corporation issued 1,000,000 share purchase warrants. Each share purchase warrant entitles the holder to acquire one common share at a price of \$0.10 until October 16, 2000. None of these warrants had been exercised at the year end.

6. Income Taxes

- a) The Corporation has incurred income tax losses which are available to offset income from operations to the extent of \$ 370,944. The value of these loss carry forwards has not been recorded in these financial statements. These losses expire in the following years:

2003	\$ 78,535
2004	\$ 97,146
2005	\$124,285
2006	\$ 70,978

- b) The provision for income taxes differs from the result which would be obtained by applying the combined Canadian Federal and Provincial income tax rate of approximately 44.3% to loss before income taxes. The difference results from the following:

	<u>1999</u>	<u>1998</u>
Computed expected recovery	\$ (114,287)	\$ (17,759)
Increase (decrease) in taxes resulting from the following:		
Crown royalties, net of Alberta royalty tax credit	1,568	-
Resource allowance	(17,426)	(1,590)
Excess (shortfall) of tax deductions over depletion	124,017	(13,866)
Other	(25,315)	(21,516)
Losses for which no tax benefit is recorded	<u>31,443</u>	<u>54,731</u>
Provision for income taxes	\$ <u> - </u>	\$ <u> - </u>

At December 31, 1999, the Corporation had net book value in excess of income tax pools in the amount of \$817,696 (1998- \$1,092,708).

7. Related Party Transactions

During the year ended December 31, 1999, the Corporation paid consulting and professional fees to companies controlled by directors of the Corporation in the amount of \$ 11,070 (1998 - \$47,328) as follows:

	<u>1999</u>	<u>1998</u>
Consulting fees	\$ 7,500	\$ 22,500
Professional fees	<u>3,570</u>	<u>24,828</u>
	\$ <u>11,070</u>	\$ <u>75,422</u>

The above transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

8. Financial Instruments

The Corporation's financial instruments that are included in the balance sheet are composed of accounts receivable, prepaid expenses and current liabilities.

(a) Fair values of financial assets and liabilities

The fair values of financial instruments (current assets, accounts payable and accrued liabilities and bank debt) that are included in the balance sheet approximate their carrying amount due to the short term maturity of those instruments.

(b) Credit risk

Virtually all of the Corporation's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

(c) Interest rate risk

The Corporation is also exposed to interest rate risk with respect to its bank credit facility. Interest thereon is charged at a rate based on prime plus per annum and is accordingly subject to fluctuation.

9. Subsequent Event

Effective January 31, 2000, the Corporation entered into a loan agreement with Backer Petroleum Corp. ("Backer"), whereby Backer agreed to lend the Corporation up to \$500,000. The funds advanced under this agreement are to be used to further develop the Corporation's major property and to repay accounts payable incurred to date with respect to that development.

The loan bears interest at Backer's cost of borrowing plus 2% and is repayable on December 31, 2000.

As security for the loan, the Corporation has provided a General Security Agreement giving a security interest over all assets and a Floating Charge Mortgage over properties now or hereafter owned by the Corporation. The security interest and mortgage are subordinate to security granted to the National Bank of Canada, as described in Note 4.

10. Uncertainty Due To The Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. Although the change in date has occurred, it is not possible to conclude that all aspects of the Year 2000 Issue which may affect the entity, including those related to the efforts of customers, suppliers or other third parties, have been fully resolved.

CORPORATE INFORMATION

Head Office

Virginia Energy Corporation
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Calgary, Alberta T2P 0S8

Telephone: (403) 205-3722

Fax: (403) 205-2722

Board of Directors

Larry D. Baker
Kenneth S. Meek¹
David S. Ragan¹
M.H. (Mike) Shaikh^{1,2}
Robert A. Wilson²
James E. Young²

Officers

Robert A. Wilson
President & Chief Executive Officer

M.H. (Mike) Shaikh
Secretary & Chief Financial Officer

David S. Ragan
Vice President Operations

- Notes:**
1. Members of the Audit Committee
 2. Members of the Compensation Committee

Abbreviations

bbls	barrels		
boe	barrel of oil equivalent of natural gas and crude oil on the basis of one barrel of crude oil for ten thousand cubic feet of natural gas (this conversion factor is not based on either energy content or current prices)		
bopd	barrels of oil per day		
boepd	barrels of oil equivalent per day		
mbbl	thousand barrels	APO	after payout
mcf	thousand cubic feet	BPO	before payout
mcfd	thousand cubic feet per day	\$M	thousand of dollars
mmcf	million cubic feet	MSTB	thousand stock tank barrels
mmcfd	million cubic feet per day	NPV	Net Present Value

Auditors

Stan Peloski
Chartered Accountant
Calgary, Alberta

Solicitors

Macleod Dixon
Calgary, Alberta

Bankers

National Bank of Canada
Calgary, Alberta

Stock Exchange Listing

Canadian Venture Exchange
Symbol "VRG"